



# Arizona State Senate Issue Brief

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# MUNICIPAL BUSINESS TAX INCENTIVES

## INTRODUCTION

There are three categories of business tax incentives employed by local governments: 1) infrastructure development, 2) economic revitalization and 3) economic development.

In Arizona, much of the debate regarding municipal tax incentives has centered on municipalities offering an incentive to businesses that would likely develop in the local area regardless of any incentive offered.

This issue brief describes the use of the three categories of municipal business tax incentives and discusses Arizona's Government Property Lease Excise Tax (GPLET) and recent Arizona legislative activity relevant to these types of incentives.

## INCENTIVES

### *Infrastructure Development*

Tax incentives may be offered in exchange for a developer paying the initial costs of public infrastructure construction. Arguments in favor of this type of incentive suggest that it can be more cost effective for the taxpayers as there are no initial costs for the municipality or interest payments resulting from bond financing. Additionally, developers may have more flexibility with the timing of a project if they are responsible for the infrastructure, rather than being dependent on a municipality's timetable.

Tax incentives may also be provided to existing businesses that are impacted by public infrastructure improvements. Street widening or realignment projects can temporarily or even permanently impact an existing business' street access, customer visibility or expansion potential. Tax incentives can be provided to offset the cost to the business for things such as street entrance, parking lot or signage modifications needed to adjust to the public infrastructure changes.

### *Economic Revitalization*

Tax incentives are used in blighted or declining areas to allow local businesses to reinvest the tax savings back into their business.

In theory, by encouraging reinvestment, the area is less likely to fall into further decline and more likely to improve. Tax incentives are sometimes offered to attract businesses to particular neighborhoods within a municipality. One example would be to offer a tax incentive to attract a supermarket to an economically depressed neighborhood. Tax incentives are also used to encourage infill development. In most cases, land in outlying incorporated or unincorporated areas is more attractive because it is relatively unencumbered when compared to infill property, which can have multiple owners and many other obstacles such as ground contamination from previous or nearby uses or existing structures already on the property.

## **Economic Development**

As previously mentioned, the largest criticism regarding tax incentives directed at municipalities is that, in some circumstances, they are offered to businesses that would locate in the area even if the tax incentives were not offered; especially when this results in neighboring cities engaging in bidding wars for a particular business.

However, proponents of tax incentives argue that in many instances a large-scale development or even a smaller business would not be built without an incentive. For example, some upscale retail stores limit their expansions and the awarding of a new location is a highly competitive process. The ability to offer a tax incentive can be the determining factor.

Tax incentives can also be used to foster the local development of businesses and jobs related to emerging markets. For example, the Arizona Bioscience Strategy plans to bring together a wide consortium of public and private entities involved in emerging technologies, such as the Translational Genomics Research Institute (Tgen). Proponents argue that creating a local base for the development of emerging technologies has tremendous economic potential. The location of such institutions is highly competitive with international competition in addition to the domestic. Once the base is created, it is argued that the area becomes the logical location for future related

institutions and industries to locate as the technology emerges.

## **Government Property Lease Excise Tax**

The GPLET was enacted in 1996 (Laws 1996, Chapter 349) to replace the tax on possessory interests that was repealed in 1995. GPLET is a local excise tax that is based on the square footage of a building rather than on its value. GPLET is levied on entities that lease the property of a city, town, county or county stadium district for commercial or industrial purposes for at least 30 days. The tax rate ranges from \$0.50 per square foot to \$1.75 per square foot depending on the height and use of the building or structure.

In addition, cities are required to abate the tax for eight years for property located in a “slum and blight area,” if the property’s lease development agreement was entered on or after April 1, 1985, and if it resulted or will result in an increase in property value of at least 100 percent. These abatements are restricted to projects within a single central business district within the slum and blight area.

Proponents of the GPLET assert that the private entity is using its tax advantage to promote public good, such as tourism, spring training baseball or economic development. Opponents argue that GPLET reduces the property tax base and shifts the property tax burden from the private entity to competitors or individuals and also pits cities against each other in bidding wars for a particular business.

## **ARIZONA LEGISLATIVE ACTIVITY**

Laws 2005, Chapter 200, requires a municipality to make a finding, by a two-thirds vote of the governing body in a municipality located in or within 25 miles of a metropolitan statistical area with more than two million persons, or by a simple majority in all other municipalities, without the use of consent calendar, before entering into a retail development tax incentive agreement. The finding must include both of the following: 1) that the proposed tax incentive is anticipated to raise more revenue than the amount of the incentive within the duration of the agreement

and 2) that the retail business or a similar retail business would not locate in the municipality in the same time, place or manner without the tax incentive. The finding must be verified by an independent third party before the municipality enters into the retail development incentive agreement and the municipality must present a public status report of the revenues and expenses associated with the tax incentive every two years for the duration of the agreement.

The legislation also establishes the same vote requirement for the adoption of a retail development tax incentive agreement by a municipality and prohibits the use of an emergency enactment. The municipality is prohibited from entering into a retail development tax incentive agreement if the proposed tax incentive will raise less revenue than the amount of the incentive.

Arizona Revised Statutes prohibits a municipality from using an emergency measure on an action by the council involving an economic development expenditure or development agreement. An action taken on an economic development expenditure and development agreement becomes effective no sooner than 30 days after final approval.

Statute establishes penalties for a municipality, if at least 65 percent of the city's or town's land is located within the exterior boundary of a metropolitan statistical area having a population of more than two million persons (currently Maricopa and Pima County), that offers or provides a tax incentive to a business as an inducement or in exchange for locating or relocating a retail business in the city or town. Affected municipalities are subject to a reduction in state shared revenue in an amount commensurate to the incentive realized by the business. An affected municipality may offer retail business incentives if the incentives are: 1) generally afforded to all new businesses in the municipality and have no direct effect on tax levies; 2) available to all retail businesses located within the municipality; 3) used to locate retail businesses in redevelopment areas; 4) used to reimburse public infrastructure dedicated to and accepted and controlled by a city, town, county, the state or private utility; 5) used to preserve historical buildings; or 6) offered for

cleanup or remediation activities at brownfield sites.

## **ADDITIONAL RESOURCES**

- GPLET: Arizona Revised Statutes; Title 41, Chapter 10, Article 5
- Retail Business Location Municipal Tax: Arizona Revised Statutes § 42-6010
- Arizona Department of Commerce <http://www.azcommerce.com/>
- League of Arizona Cities and Towns [www.azleague.org](http://www.azleague.org)
- City of Phoenix [www.phoenix.gov](http://www.phoenix.gov)